No. 8092.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

In the Matter of
WILLIAM DILLER,
Bankrupt.

William Diller,
Appellant,

vs.

Michael Shoemaker, John Hancock Mutual Life Insurance Company, a corporation, and California Trust Company, a corporation,
Appellees.

BRIEF OF APPELLEES JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY AND CALIFORNIA TRUST COMPANY.

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PRELIMINARY STATEMENT.

Since the condensed statement of facts set forth on pages 3 to 7 of the appellant's opening brief is in the main correct, we will not burden the Court with a further statement. However, during the course of our argument,

it will be necessary to amplify the appellant's statement in some particulars, which we will do by appropriate references to the Agreed Statement of Facts, set forth on pages 6 to 22 of the Transcript of Record.

We believe it fitting to identify the appellees upon whose behalf this brief is filed. At the time the proceedings were instituted, appellee John Hancock Mutual Life Insurance Company (hereinafter referred to as the "Hancock Company" or "appellee") was the owner and holder of an unpaid promissory note executed by appellant Diller, and was the beneficiary of a California trust deed upon real property in the city of Los Angeles, executed by the appellant to secure the payment of the promissory note. Appellee California Trust Company is a party solely because it was named as trustee under this trust deed, as such was legal owner of the real property subject to the encumbrance, and therefore was a necessary party to any proceeding restraining or allowing the enforcement of the beneficiary's rights under the trust deed. Appellee Michael Shoemaker, upon whose behalf a separate brief is being filed, was the owner of a promissory note and a trust deed to secure the same, which trust deed affected ranch property situated some fifty miles away from Los Angeles.

The statute involved in this appeal is Subsection (s) of Section 75 of the Bankruptcy Act, as amended by Act of Congress August 28, 1935, c. 792, Sec. 6, 49 Stat. 942 (Title 11 U. S. C. A., Sec. 203(s)), which subsection

is popularly referred to as the Frazier-Lemke Act, and hereafter when we mention the Frazier-Lemke Act we will refer to the one presently in force. There have been two Frazier-Lemke Acts. The first, enacted in 1934, was held unconstitutional by the Supreme Court in *Louisville Joint Stock Land Bank v. Radford,* 295 U. S. 555, 79 L. Ed. 1593 (May, 1935). The present Act was passed by the Congress in August, 1935. Section 75 of the Bankruptcy Act is a new section originally enacted in 1933. Its purpose was to assist farmer debtors. Subsections (a) to (r) provide a method for a farmer to effect with his creditors a composition and an extension of time for the payment of his debts without being adjudicated a bankrupt. Subsection (s) provides for the adjudication of the farmer debtor as a bankrupt and grants him the property for a certain length of time, during which he has the right to retain the property and attempt to refinance it.

The appellant has presented his argument in two divisions: First, that the attack upon the constitutionality of the Frazier-Lemke Act is premature; second, that the Frazier-Lemke Act is constitutional. We will answer appellant's arguments in the same order, and will then present to the Court additional reasons for affirming the judgment of the District Court.

BRIEF SUMMARY OF THE ARGUMENT.

I. The District Court properly undertook to determine the constitutionality of Bankruptcy Act, Section 75(s) as amended.

A. The objection that the District Court prematurely considered the constitutionality of the Frazier-Lemke Act is not properly before this Court and therefore cannot be considered by it.

Baldwin v. United States, 72 Fed. (2d) 810 at 812 (C. C. A. 9th, 1934);

Holsman v. United States, 284 Fed. 193 at 198 (C. C. A. 9th, 1917);

Hathaway & Company v. United States, 249 U. S. 460, 63 L. Ed. 707 (1919);

Morrill v. Jones, 106 U. S. 466, 27 L. Ed. 267 (1883).

B. At the date of the hearing before the District Court appellees had already suffered injury by reason of the operation of the Frazier-Lemke Act, additional injury was threatened, and the necessary result of the Statute was to affect adversely existing property rights of appellees.

Pierce v. Society of Sisters, 268 U. S. 510, 69 L. Ed. 1070 (1925);

Village of Euclid v. Ambler Realty Co., 272 U. S. 365, 71 L. Ed. 303 (1926);

Terrace v. Thompson, 263 U. S. 197, 68 L. Ed. 255 (1923);

United States National Bank of Omaha v. Pamp, 83 Fed. (2d) 493 (C. C. A. 8th, May 11, 1936).

II. The present Frazier-Lemke Act is unconstitutional in that it violates Article I, Section 8, of the Constitution of the United States, and Articles V and X of the Amendments to the Constitution of the United States.

A. The Frazier-Lemke Act is an attempt by the Congress, acting under the guise of enacting a law upon the subject of bankruptcy, to regulate and change property rights established by state law.

United States v. Fox, 94 U. S. 315 at page 320, 24 L. Ed. 192 at page 193 (1877);

Watkins v. Lessee of Holman, 41 U. S. 25 at page 57 (16 Pet. 25 at page 57), 10 L. Ed. 873 at page 886 (1842);

Langdon v. Sherwood, 124 U. S. 74 at page 81, 31 L. Ed. 344 at page 345 (1888);

In re Young, 12 Fed. Supp. 30 (D. C. Ill., 1935);

In re Sherman, 12 Fed. Supp. 297 (D. C. Va., 1935);

United States v. Butler, 297 U. S. 1, 80 L. Ed. Adv. Op. 287 (1936);

McCulloch v. Maryland, 4 Wheat. 316 at 423, 4 L. Ed. 579 at 605 (1819);

Bailey v. Drexel Furniture Company, 259 U. S. 20, 66 L. Ed. 817 (1922);

United States v. Constantine, ... U. S. ....., 80 L. Ed. Adv. Op. 195 (1935);

In re Lowmon, 79 Fed. (2d) 887 (C. C. A. 7th, 1935).

B. The Frazier-Lemke Act is an attempt by the Congress to take property without due process of law.

Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 79 L. Ed. 1593 (May, 1935);

In re Sherman, 12 Fed. Supp. 297 (D. C. Va. 1935);

In re Young, 12 Fed. Supp. 30 (D. C. Ill., 1935).

C. The Frazier-Lemke Act is an attempt by the Congress to exercise the police powers which are reserved to the states.

Home Building & Loan Association v. Blaisdell, 290 U. S. 398, 78 L. Ed. 413 (1934);

Gibbons v. Ogden, 9 Wheat. 1 at 203, 6 L. Ed. 23 (1824);

United States v. Butler, 297 U. S. 1, 80 L. Ed. Adv. Op. 287 (1936);

Carter v. Carter Coal Co., ... U. S. ....., 80 L. Ed. Adv. Op. 749 (1936);

In re Slaughter, 13 Fed. Supp. 893 (D. C. Tex., 1936).

D. The Frazier-Lemke Act is not a uniform law on the subject of bankruptcies.

Washington v. Pratt, 8 Wheat. 681, 5 L. Ed. 714 (1823);

In re Slaughter, 12 Fed. Supp. 206 (D. C. Tex., 1935).

III. Irrespective of the constitutionality of the Frazier-Lemke Act, under the facts of the case at bar, the judgment of the District Court should be affirmed.

A. The Frazier-Lemke Act is inapplicable to the situation presented by the facts of the case at bar.

Montgomery v. Gilbert, 77 Fed. (2d) 39 (C. C. A. 9th, 1935);

McCloskey v. Pacific Coast Co., 160 Fed. 794 (C. C. A. 9th, 1908);

Mosley v. Manhattan Oil Co., 52 Fed. (2d) 364 (C. C. A. 8th, 1931) (certiorari denied, 284 U. S. 677, 76 L. Ed. 572, 1931).

B. Appellant had no *bona fide* hope of eventual rehabilitation, and therefore his petition for relief under the Frazier-Lemke Act was not filed in good faith.

In re Borgelt, 79 Fed. (2d) 929 (C. C. A. 7th, 1935);

In re Byrd, 15 Fed. Supp. 453 (D. C. Md., 1936);

In re Slaughter, 13 Fed. Supp. 893 (D. C. Tex., 1936).

ARGUMENT.

I.

The District Court Properly Undertook to Determine the Constitutionality of Bankruptcy Act, Section 75(s), as Amended.

It is only because the appellant has devoted a substantial portion of his brief (App. Op. Br. pp. 10 to 16) to raising and arguing the point that the District Court considered the constitutionality of the Frazier-Lemke Act prematurely that we deem it necessary to meet such issue. We believe and propose to show that the appellant's argument is erroneous upon two grounds: First, procedural; and, second, substantive.

A. The Objection That the District Court Prematurely Considered the Constitutionality of the Frazier-Lemke Act Is Not Properly Before This Court and Therefore Cannot Be Considered by It.

The procedural reason is that appellant did not present this "premature" argument to the District Court; it was not assigned as error and, accordingly, is raised for the first time in appellant's brief.

The agreed statement of the case [Tr. pp. 6 to 22] does not state that this argument was made to the District Court, and error was not assigned upon this ground [Tr. pp. 38 and 39]. Furthermore, appellant's brief carefully avoids directly charging that the District Court committed error in considering the constitutionality of the statute; also, it is to be noted that in the Court below the appellant joined in the argument upon the constitutionality of the Act and contended that the Act was valid. Accord-

ingly, the raising of the issue on appeal is a clear violation of the rules of this Court (Rules 11 and 24, C. C. A. 9) and of this Court's uniform decisions that *errors argued in the brief but not assigned as error will not be considered.*

See *Baldwin v. United States,* 72 Fed. (2d) 810 at 812 (C. C. A. 9th, 1934), where this Court said:

> "many alleged errors are argued in the briefs which were not assigned as error. This court has repeatedly held that errors argued in the briefs but not assigned as error will not be considered."

Holsman v. United States, 248 Fed. 193 at 198 (C. C. A. 9th, 1917):

> "Counsel for appellants have discussed in their briefs . . . certain matters respecting which it is claimed that error was committed by the court, but we have searched in vain among the assignments of error filed on the appeal for any assignments respecting these matters. For this reason, such alleged errors cannot be insisted upon here, and this court is therefore not called upon to look into them."

The rule is, of course, the same in the Supreme Court of the United States.

See *Hathaway & Company v. United States,* 249 U. S. 460, 63 L. Ed. 707 (1919).

Morrill v. Jones, 106 U. S. 466, 27 L. Ed. 267 (1883), where the Court held:

> "It is a sufficient answer to this objection that no such point was made below. The court was not asked to rule on any such question. Our examination is confined to such exceptions as were taken to the rulings actually made on the trial and incorporated in some form into the record, an authenticated transcript of which is returned with our writ of error."

B. At the Date of the Hearing Before the District Court Appellees Had Already Suffered Injury by Reason of the Operation of the Frazier-Lemke Act, Additional Injury Was Threatened, and the Necessary Result of the Statute Was to Affect Adversely Existing Property Rights of Appellees.

The substantive reason why appellant's argument is wrong is that the transcript shows that at the hearing before the District Court there was presented to the Court a definite showing of injury already suffered by the appellees as a proximate result of the Frazier-Lemke Act, and also that additional injury to the appellees' existing property rights was immediately threatened. The appellees were not seeking to have the trial court render an abstract decision on constitutional law. They were seeking relief from a statute, the operation of which had already injured them.

But what *does* the record show was the picture presented to the District Court in November, 1935? Very briefly, it was as follows:

The appellant occupied a large house in an exclusive residential district in the city of Los Angeles; this house was subject to an encumbrance in the principal amount of $20,000.00, held by appellee; appellant had paid no interest upon the debt since July, 1932, which was more than three years before the hearing; appellant had paid no taxes upon the property since 1931, appellee had advanced taxes for three years, and one year's taxes were delinquent; the total debt was $27,434.06 [Tr. pp. 10 and 11]. Since September, 1934, appellant had effectively prevented appellee from collecting any of the in-

debtedness by a resort to successive proceedings under Section 75 of the Bankruptcy Act, having twice failed to effect a composition and extension with his numerous creditors [Tr. pp. 6 and 9], and having twice been adjudicated a bankrupt under the successive Frazier-Lemke Acts [Tr. pp. 6 and 9]. In his compromise offer of September 18, 1935, the debtor had offered to pay appellee for the property only $21,610.00, which was the value of the property fixed by appraisers appointed by the Court, which sum was approximately $6,000.00 less than the amount of the debt [Tr. pp. 6 to 17]. It is not surprising that appellee refused this offer.

With such a picture of a property with an appraised value much less than the encumbrance, of a property daily *decreasing* in value, of a debt daily *increasing,* of many years' taxes unpaid by the debtor, of three years' interest unpaid, of litigation covering more than a year, during which the creditor was subjected to delay and consequent further loss because it was enjoined by the statute from enforcing its rights, could the District Court have denied that at the time of the hearing this appellee had already suffered very substantial injury to its property rights, and that additional injury was threatened as the necessary result of the operation of the Frazier-Lemke Act? For it was the necessary result of the Frazier-Lemke Act, since all proceedings by a creditor are specifically stayed by Subsections (o) and (p) of the same Section 75 of the Bankruptcy Act.

Appellant at this point argues (App. Op. Br. pp. 11 and 12) that at the time of the hearing there was nothing to prevent appellee from proceeding to enforce the security, but this statement entirely overlooks the specific injunction

against so proceeding contained in Subsections (o) and (p), which injunctions in terms include *all* proceedings under Section 75. The appellant also disregards the fact that he made strenuous effort before this Court to obtain an order restraining the sale without the posting of a supersedeas bond. However, if the appellant's position is correct, this appeal is moot and should be dismissed, for the record of the proceedings before this Court shows that upon the failure of the appellant to post the supersedeas bond as ordered by the Court, appellees proceeded to sell the property in accordance with the provisions of the trust deed, and the appellant no longer owns the property.

The appellant also attempts to argue that the property had not been appraised (App. Op. Br. p. 12), but this also overlooks the fact that only two months before the hearing the appellant, in his proposal for composition, had offered to buy the property for a sum which had been fixed as its value by appraisers appointed in the proceeding [Tr. p. 17], and at the hearing it was admitted that appraisers appointed in the proceedings had so valued the property [Tr. p. 20].

It is unreasonable to assume that the property's value had changed in two months, or even that there would have been an entirely new appraisal—the appellant would have allowed the appraisal figure to stand.

From the authorities cited by the appellant to support his contention of premature consideration, he attempts, on page 12, to state a "well-established doctrine of law" as

controlling. But such authorities do not establish such a strict rule. Rather, they are in complete accord with the general rule that a party may not request the courts to declare an act unconstitutional unless he can show that he has sustained or is threatened with the present danger of sustaining injury as a result of the present operation of the statute, but that he need not postpone his request for relief until *all* the requirements prescribed for effecting such injury have been carried out.

The courts have frequently decided constitutionality of statutes when injury had not been sustained but was threatened and would necessarily follow the enforcement of the statute.

In *Pierce v. Society of Sisters,* 268 U. S. 510; 69 L. Ed. 1070 (1925), the Supreme Court held a school law unconstitutional although the act was not to take effect for a period of two years after the attack was made upon it. The Court specifically held that the suit was not premature.

In *Village of Euclid v. Ambler Realty Co., 272* U. S. 365, 71 L. Ed. 303 (1926), the constitutionality of a zoning ordinance was under consideration. The defendant argued that the constitutional attack was premature because the plaintiff had made no effort to secure a building permit. The Court held that the action was not prematurely brought, since the very existence of the ordinance constituted a "present invasion of appellee's property rights and a threat to continue it".

And, again, *Terrace v. Thompson,* 263 U. S. 197, 68 L. Ed. 255 (1923), was an action involving the alien land law of the state of Washington. The defendant contended that the plaintiff should have postponed his constitutional argument until he had made a lease and lost his property through the enforcement of the land law. The Court held that the action was not premature, and said, in language surprisingly applicable to the case at bar:

> "The Terraces' property rights in the land include the right to use, lease and dispose of it for lawful purposes and the Constitution protects the essential attributes of property."

The authorities cited by the appellant actually afford him slight comfort and assistance when examined:

The case of *In re Bennett,* 13 Fed. Supp. 353 (D. C. Mo., 1936), quotations from which appear on pages 39 to 43 of appellant's brief, we submit is not now the law, since the Circuit Court of Appeals for the Eighth Circuit thereafter held the Frazier-Lemke Act unconstitutional in *United States National Bank of Omaha v. Pamp,* 83 Fed. (2d) 493 (C. C. A. 8th, May, 1936).

In *Dallas Joint Stock Land Bank v. Davis,* 83 Fed. (2d) 322 (C. C. A. 5th, 1936), cited on pages 13 and 14 of appellant's brief, the Court affirmed the denial of a motion to dismiss proceedings under the Frazier-Lemke Act. But it is essential to note that such denial was affirmed specifically *without prejudice* to the renewal of the motion if the appellant was later deprived of property rights. The

Court rightly refused to hand down a declaratory opinion. The Court admits that:

> "if the necessary result of the act is to take away appellant's substantial rights in its security, it need not wait until all the forms prescribed for that taking away have been gone through with, but may sue at once to save itself."

In *United States National Bank of Omaha v. Pamp,* 77 Fed. (2d) 9 (C. C. A. 8th, 1935), cited on page 15 of appellant's brief, the opinion discloses that the farmer debtor had not even filed a petition for relief under the Frazier-Lemke Act, but was still proceeding under the (a) to (r) subsections of Section 75. The plaintiff, who was seeking to foreclose, made the specious argument that the Frazier-Lemke Act was unconstitutional, and therefore the rest of Section 75 was also unconstitutional, which argument naturally did not appeal to the Court. The portion of the opinion quoted in the appellant's brief was a mere gratuitous pronouncement by the court, and further along in the opinion the court specifically refrains from expressing any opinion on the constitutionality of the Frazier-Lemke Act. It is pertinent to note that one year later, in a case involving the same parties, after the farmer debtor had filed his petition under the present Frazier-Lemke Act, the same Court did not hesitate to condemn said Act as unconstitutional in *United States National Bank of Omaha v. Pamp,* 83 Fed. (2d) 493 (C. C. A. 8th, May 11, 1936).

II.

The Present Frazier-Lemke Act Is Unconstitutional in That it Violates Article I, Section 8, of the Constitution of the United States, and Articles V and X of the Amendments to the Constitution of the United States.

The portion of the appellant's brief dealing with the constitutionality of the amended Act commences with an admonition to the Court to allow a so-called presumption of constitutionality to operate, and thus conveniently sidestep the necessity of deciding the constitutionality of the statute. Then follow exhausting analyses of the two Frazier-Lemke Acts, and of the *Radford* decision; an attempt to justify a federal taking of property by using principles applicable solely to the exercise of the state police power; and, in conclusion, there is presented an appealing picture of the Congress, faced with the sweeping condemnation of the original Frazier-Lemke Act set forth in the *Radford* decision, again striving to accomplish exactly the same results in a constitutional manner.

It occurs to us that in the presentation of our argument that the Act is unconstitutional, it will tend to clarity and will assist the Court if we discuss the provisions of the Constitution pertinent to the Act being considered, and in the course of such discussion answer the appellant's argument at appropriate points.

A word, however, with respect to the argument of the presumption of constitutionality. The argument is simply this: The Congress thought the Act was constitutional, therefore it must be, and the courts must so hold. The argument thus presented is a good example of attempting

to lift one's self by one's bootstraps. To be sure, it is to be presumed that the Congress will not consciously enact an unconstitutional statute, for to do so would be a clear breach of its duty to the nation. But it is another matter thereafter to insist that the courts, in construing such statute, be governed by this opinion, for this would be depriving the courts of the right and duty granted and imposed upon them by the Constitution to be the sole arbiter of the validity of the laws passed by the Congress. Carried to its logical conclusion, the argument would force the courts to hold all laws constitutional without question, and our governmental system of keeping separate the powers to make and to construe laws would disintegrate.

But fortunately such is not the case, and the books are filled with solemn warnings to the courts jealously to guard the citizens' rights against stealthy and unlawful encroachments by the Legislature. It is, of course, appropriate for the courts to examine legislative debates when construing an ambiguous statute, but the purpose of such examination is to ascertain the purpose and true meaning of the statute—not to discover the opinion of the lawmakers upon the validity of the act and be guided by it. In fact, this latter attitude would cast aspersions upon the integrity of the legislator, for it is his duty to pass only those laws which he believes valid. Indeed, a study of the debates cited by appellant indicates that there was a doubt as to the power of Congress to enact such a law, and this doubt is epitomized by Senator McCarran's remark, quoted on page 47 of the appellant's brief, "*if* any bill can be enacted which will be constitutional it will be a bill along these particular lines". (Italics ours.) After

all, was the constitutionality of this Act the paramount consideration, as argued on page 46 of appellant's brief? Was not the main consideration, rather, the desire to assist farmers? Paragraph 6 of the Act itself specifically declares it is an emergency measure.

A. The Frazier-Lemke Act Is an Attempt by the Congress, Acting Under the Guise of Enacting a Law Upon the Subject of Bankruptcy, to Regulate and Change Property Rights Established by State Law.

Article I, Section 8, of the Constitution grants to the Federal Congress the power to establish "uniform laws on the subject of bankruptcies throughout the several states". However, during the life of the nation bankruptcy laws have been in effect for only about one-third of the time (1 *Remington on Bankruptcy,* 4th ed., pp. 14 to 17), and this fact will be referred to hereafter in our argument.

It has long been established that the laws of the state in which real property is situated exclusively govern the manner and mode of its transfer.

In *United States v. Fox,* 94 U. S. 315 at page 320, 24 L. Ed. 192 at page 193 (1877), the Court said:

> "The title and modes of disposition of real property within the state, whether *inter vivos* or testamentary, are not matters placed under the control of federal authority. Such control would be foreign to the purposes for which the Federal Government was created, and would seriously embarrass the landed interests of the state."

In *Watkins v. Lessee of Holman,* 41 U. S. 25 at page 57 (16 Pet. 25 at page 57), 10 L. Ed. 873 at page 886 (1842), it is said:

> "And no principle is better established than that the disposition of real estate, whether by deed, descent, or by any other mode, must be governed by the law of the state where the land is situated."

And in *Langdon v. Sherwood,* 124 U. S. 74 at page 81, 31 L. Ed. 344 at page 345 (1888), it is said:

> "The question of the mode of transferring real estate is one peculiarly within the jurisdiction of the legislative power of the state in which the land lies."

Accordingly, the manner of incumbering land as security for a debt and the manner of enforcing said security rest exclusively upon the laws of the state in which the land is located, and it follows that the Federal Government has no power to regulate or change the manner or mode of enforcing such security.

As the transcript sets forth, the Hancock Company, at the time the appellant instituted his proceedings, was the owner and holder of a promissory note secured by a trust deed upon real property of the debtor. This trust deed was in the customary California form [Tr. p. 11], with which the Court is undoubtedly familiar. Under the California law applicable to this trust deed, which, as above indicated, governs the manner of transferring interests in real property lying in the state, the beneficiary of a trust deed, upon default of the debtor, has, among others, the following rights:

Immediately to institute proceedings resulting in a sale of the security, which sale can be held at least within

four months (California Civil Code, Section 2924); to have an absolute sale with no period of redemption; to have such sale a private one, as distinguished from a public judicial sale, as upon execution; to obtain immediate possession of the property at the date of the sale; and to obtain a deficiency judgment against the debtor if the security does not sell for the amount of the debt. All of these rights are valuable property rights granted by California law.

The next question is: Has the holder of the trust deed the same rights under the Frazier-Lemke Act? The answer is, he has not; and the Congress, in enacting the Statute, has attempted to allow the Federal Government to regulate property rights established by the states.

That these substantial property rights have been taken away from the appellee is evident. The appellant admits (App. Op. Br. pp. 24 and 25) that the Act takes away the right to decide when the sale shall be held, and that this right will be held in abeyance for *three* years while the debtor tries to refinance himself. In California this right is even stronger than the similar right held to have been taken in the *Radford* case, for in California the creditor is not subject to the discretion of the Court in having his sale. Appellant also admits the impairment of the right to control the property during the period of default, and to receive the rents and profits during such period. This is a serious matter, for there is the constant danger of waste, depreciation and disrepair, with additional loss to the creditor, as pointed out in the *Radford* case, in spite of the fact that there is no assurance, and there can be none, that the debtor will be able to extricate himself from his position at the end of the three-year

period granted. In answer to this the debtor might argue that the Statute requires him to pay rent. However, the rent is not payable for one year, and it is not certain whether the rent will ever be paid, since no security is required to insure such payment. If the debtor is unable to refinance his obligation the holder of the encumbrance will finally obtain the property, probably in a wasted condition.

The right to have the sale absolute and to obtain immediate possession with no period of redemption was not discussed in the *Radford* case, but in this respect again the Frazier-Lemke Act changes the rights and grants a period of redemption where none before existed (paragraph 3 of Subsection (s)). This addition is also important, for we believe the court can take judicial notice of the widespread preference of California investors for trust deeds rather than mortgages, for the redemption period granted the mortgagor, and during which he retains possession, offers him ample opportunity to milk the property. This additional creation of a redemption period is well discussed in *In re Young,* 12 Fed. Supp. 30 (D. C. Ill., 1935), and in *In re Sherman,* 12 Fed. Supp. 297 (D. C. Va., 1935), and it was also mentioned in the opinion of the District Judge in the case at bar.

The right to have a private sale, which is taken away by the requirement of a public judicial sale, set forth in paragraph 3 of Subsection (s), may not seem particularly important, but this also adds to the burdens already resting upon the creditor. It is well known that practically all trust deed sales are privately conducted by the trustee, with no court proceedings with the attendant delays and added expense involved.

From the above discussion it is apparent that the Act has done far more than only grant the debtor a breathing space, as appellant argues on page 23. In fact, it has vitally changed, impaired and denied rights granted by the state law, and has thus regulated the internal affairs of the state. But under what constitutional grant of authority is it contended that this is justified? Simply under the catch-all of the "broad bankruptcy powers" granted to the Congress by Article I, Section 8 of the Constitution.

However, it is clear from a study of the Frazier-Lemke Act and a comparison of the prior sections of the Bankruptcy Act of 1898, that Subsection (s) is not in fact bankruptcy legislation, although it is conveniently added to the Bankruptcy Act. The intent, purpose and result of the Bankruptcy Act as it stood prior to the enactment of Section 75 was to provide a simple and equitable method to liquidate the estate of the debtor and to distribute such estate to his creditors, all the while recognizing the rights established by state laws. The Frazier-Lemke Act does not operate in this manner. Rather, instead of distributing the estate to the creditors it takes from the creditor a large part of his interest in the estate and give such interest to the debtor and, in addition, actually gives the debtor more rights than he had before, or had bargained for, under state law.

Since this is the necessary operation of the Act, it must have been the true intent of the Congress, in enacting it, thus to alter and regulate the rights established by the

states. Therefore, this Act is not bankruptcy legislation, but is a regulation by the Federal Government of state contract rights under the guise of bankruptcy legislation. The Congress has no power to do this. A comparison of the original Frazier-Lemke Act and the present one discloses that the underlying purpose of both acts was, as said in the *Radford* case, and the words are equally applicable to the present Act, "to preserve to the mortgagor the ownership and enjoyment of the farm property" and "to take from the mortgagee rights in the specific property held as security". The difference, if any, between the two acts is one of degree only, and not of substance.

Fortunately, however, the courts have been watchful to strike down legislative attempts to accomplish prohibited ends under the pretext of exercising powers which were granted. Thus, in *United States v. Butler,* 297 U. S. 1, 80 L. Ed. Adv. Op. 287 (1936), the Court held invalid an act of Congress which attempted to regulate crop production in the several states under the guise of exercising the Federal taxing power. The Court said:

> "It is an established principle that the attainment of a prohibited end may not be accomplished under the pretext of an assertion of powers which are granted."

And in *McCulloch v. Maryland,* 4 Wheat. 316 at 423, 4 L. Ed. 579 at 605 (1819), Chief Justice Marshall said:

> "Should Congress, in the execution of its powers, adopt measures which are prohibited by the Constitution; or should Congress, under the pretext of exe-

> cuting its powers, pass laws for the accomplishment of objects not entrusted to the government, it would become the painful duty of this tribunal, should a case requiring such a decision come before it, to say that such an act was not the law of the land."

See, also, for purported exercise of the taxing power held invalid:

> *Bailey v. Drexel Furniture Company,* 259 U. S. 20, 66 L. Ed. 817 (1922) (the child labor tax case);
>
> *United States v. Constantine,* ..... U. S. ....., 80 L. Ed. Adv. Op. 195 (1935).

It is significant that the Court in the above cases prohibited the use by the Congress of its undoubted, essential and sovereign taxing powers when such use was merely a subterfuge to accomplish ends not within the Federal power to effect. If the exercising of the taxing power is so closely scrutinized, the more closely should the exercise of the bankruptcy power be examined to discover invalid acts passed in its name, for the bankruptcy power is of far less importance to the nation than the taxing power and, as pointed out above, bankruptcy laws have been in effect for only one-third of our national life.

In *In re Lowmon,* 79 Fed. (2d) 887 (C. C. A. 7th, 1935), the Court said:

> "Where property rights are regulated by the state law, Congress has no right under the bankruptcy power to alter those rights."

We submit that the Frazier-Lemke Act is an attempt to use the bankruptcy power to regulate matters solely within the power reserved to the states, and is therefore invalid.

B. The Frazier-Lemke Act Is an Attempt by the Congress to Take Property Without Due Process of Law.

But the necessary result of this abortive attempt to use the bankruptcy power, as set forth in the next preceding portion of our argument, has been simply to run afoul of the fifth constitutional amendment, which prohibits the taking of property without due process. The bankruptcy power is subject to the terms of the Fifth Amendment, as pointed out by Brandeis, J., in the *Radford* case, at page 602 (295 U. S.) and at page 1611 (79 L. Ed.):

> "For the Fifth Amendment commands that, however great the nation's need, private property shall not be thus taken, even for a wholly public use without just compensation. If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public."

We have indicated in the preceding portion of this brief some of the property rights which are thus invalidly taken by the operation of the Statute. The description of that taking could be amplified at length, and additional property rights taken from the appellee by the Act could be enumerated. Almost all of the decisions which have been handed down upon the present Frazier-Lemke Act list the five property rights of the Kentucky mortgagee which the *Radford* case held had been invalidly taken away by the former Act, and so we will not burden the

Court by a repetition of the list. However, it is not to be assumed that that list was intended as an exclusive one and that there could not be other rights which were taken invalidly. The *Radford* list was only an enumeration of the five Kentucky property rights of which the mortgagee was wrongfully deprived, and it was unnecessary to list more lost rights. Even though the present act cured these now-famous five defects, this would be no assurance that the Act would be constitutional, for other states would have granted different rights which might be impaired by the Act. In fact, we have enumerated additional California property rights of which the appellee is deprived. And these additional rights are of equal importance. The draughtsmen of the present Act patently overlooked the fact that the *Radford* case was dealing only with rights established by Kentucky law. As is said in *In re Sherman,* 12 Fed. Supp. 297 (D. C. Va., 1935), in discussing the *Radford* list:

> "I do not understand that the opinion purports to name all of the property rights affected or to say that those enumerated are the only ones affected. Presumably, it named those to which its attention was most forcibly drawn."

See, also, *In re Young,* 12 Fed. Supp. 30 (D. C. Ill., 1935), wherein additional property rights are enumerated.

Even the appellant *concedes* that the present Act does not cure two of the defects of the former law, but then he makes the amazing argument that now, since only two of appellee's property rights are adversely affected, instead of the five listed before, this Court should hold the present Act unobjectionable. We do not understand that the Fifth Amendment operates in this way, nor

can we discover that the *Radford* case attempted to evaluate the relative importance of the rights taken. It would appear that if the act deprives appellee of only one of its property rights the act must fall. The Court's concern is not *how many* rights are taken wrongfully, but, rather, its inquiry is and must be directed to determine *if any* rights are so taken. We have demonstrated that the present Act has taken away many of appellee's rights; that such taking was without due process, and therefore we submit that the Act must be held invalid as a violation of the Fifth Amendment.

C. The Frazier-Lemke Act Is an Attempt by the Congress to Exercise the Police Powers Which Are Reserved to the States.

In 1934 the Supreme Court held the Minnesota mortgage moratorium law constitutional in *Home Building & Loan Association v. Blaisdell,* 290 U. S. 398, 78 L. Ed. 413 (1934). The Minnesota statute granted a moratorium on foreclosures for a period of not more than two years, upon certain conditions designed to protect the mortgagee in the interim. Many of the states, including California, have enacted similar moratory legislation in the past few years. However, at the outset of this part of our discussion, we desire to emphasize the fact that the Court upheld this statute squarely upon the ground that it was a proper exercise of the police powers reserved to the several states by the Tenth Amendment.

What these police powers are is difficult to define. Chief Justice Marshall described them as "that immense mass of legislation which embraces everything within the territory of a state not surrendered to the Federal Govern-

ment", (*Gibbons v. Ogden,* 9 Wheat. 1, at 203, 6 L. Ed. 23 (1824).)

However, these powers include the right of the states to alter or impair the property rights of their citizens, even the rights to enforce security liens upon land, provided that such alteration or impairment promotes the best interests of the state and its citizens, that is, if it is for the general welfare, and it is established that this alteration of rights by the states does not violate the Fourteenth Amendment.

It has long been established, however, that the Federal Government does not have such police powers, for under our governmental system of delegated power the Federal Government's powers are strictly enumerated by the Constitution, and those not granted are reserved to the states, and this reservation is protected by the Tenth Amendment. The states have not surrendered their police powers.

See:

United States v. Butler, supra;

Carter v. Carter Coal Co., ... U. S. ....., 80 L. Ed. Adv. Op. 749 (1936).

In spite of this great distinction between the exercise of the reserved police powers by the state and the attempted exercise of those same powers by the Congress, the appellant argues that, since the state of Minnesota could enact moratorium legislation under its police powers, in spite of the Fourteenth Amendment, therefore the Congress can also enact such laws under its bankruptcy

powers, in spite of the Fifth Amendment. And, further, that the *Blaisdell* case is the yardstick for the Court to use to determine whether the Federal impairment is reasonable. The appellant even asks us to assume that the power to enact mortgage moratorium legislation exists in both state and national legislatures (App. Op. Br. p. 27). Such assumption and argument are fallacious, because they ignore the great and fundamental difference between the exercise of reserved powers and the attempted exercise of powers not granted. The one case is the exercise of power which one admittedly has; and the other is the attempted exercise of power which one specifically has not. Nor can we agree that Mr. Justice Brandeis missed this fundamental distinction between the Minnesota moratorium statute and the Frazier-Lemke Act.

In *In re Slaughter,* 13 Fed. Supp. 893 (D. C. Tex., 1936), a case especially interesting, as hereafter shown, the Court said:

> "Definitely the national government has no moratorium granting power. The authority of the state of Minnesota to stay proceedings, as sustained in Home Building & Loan Association v. Blaisdell, 290 U. S. 398, 54 S. Ct. 231, 78 L. Ed. 413, 88 A. L. R. 1481, was never intended to indicate that the national government had any such power."

It is patent that, in determining the constitutionality of the Frazier-Lemke Act, this Court must not rely upon the *Blaisdell* yardstick, although the appellant, the Congress and the learned District Judge in *In re Reichert,*

13 Fed. Supp. 1 (D. C. Ky., 1936), wrongly did so, but, rather, the yardstick this Court must use is: What powers does the Constitution grant to the Congress?

D. The Frazier-Lemke Act Is Not a Uniform Law on the Subject of Bankruptcies.

Lastly, we come to the argument that, even if the Congress had the power to enact a statute accomplishing the results intended by the Frazier-Lemke Act, still the present Act would be unconstitutional, because it is not a *uniform* law on the subject of bankruptcies *throughout* the several states. We refer to paragraph 6 of Subsection (s), which states that the Act is an emergency measure, and if in the Court's judgment the emergency has ceased to exist in its locality, the stay may be shortened.

Especially in view of the fact that laws affecting property rights must be construed strictly (*Washington v. Pratt,* 8 Wheat. 681, 5 L. Ed. 714 (1823),) the Frazier-Lemke Act does not present a law having that geographical uniformity which is recognized as requisite before a statute can be valid. Paragraph 6 of Subsection (s) expressly allows the Court in each of the many Federal Judicial Districts throughout the country to determine the cessation of the emergency. The stay granted to the debtor is not dependent upon the continuance of the national emergency, but, rather, upon its continuance in the particular locality in which the Court sits. The free exercise of this power by the courts would produce unusual results so obvious as to make it unnecessary to list them. The paragraph

lists no criteria to assist the courts in determining when the emergency is at an end. The provision, contrary to the Constitution and our governmental theory, thus delegates legislative power to the judiciary. Even one of the decisions which decided with express doubt that the Frazier-Lemke Act is constitutional also held that this paragraph 6 is clearly unconstitutional.

> *In re Slaughter,* 12 Fed. Supp. 206 (D. C. Tex., 1935).

If it is argued that this paragraph is severable from the rest of the Act, such argument is met by the strict construction rule just discussed. It is met further by an examination of the entire Subsection (s), which discloses clearly the intent to enact a law in a time of stress, and the provision in paragraph 6 that "this act is hereby declared to be an emergency measure" is merely a frank admission of this fact. Further, if this paragraph 6 is severed from the preceding ones the result is that a stay for a fixed three-year period is granted, and one of the grounds upon which the Court in the *Radford* case distinguished the *Blaisdell* case was that the stay granted by the first Frazier-Lemke Act was inflexible.

During the course of this division of our argument we have not burdened the Court with extensive citation or quotations from the decisions which have held the present Subsection (s) unconstitutional. Numerically, the decisions holding the Act void are twice the number of those

upholding it. Naturally, we consider these opinions are more carefully written and present the correct view of the law and, for the convenience of the Court, we list them here with no further comment, except respectfully to suggest that the decisions in the *Pamp* and *Sherman* cases merit particular attention:

United States National Bank of Omaha v. Pamp, 83 Fed. (2d) 493 (C. C. A. 8th, 1936);

In re Lowmon, 79 Fed. (2d) 887 (C. C. A. 7th, 1935);

In re Young, 12 Fed. Supp. 30 (D. C. Ill., 1935);

In re Sherman, 12 Fed. Supp. 297 (D. C. Va., 1935);

In re Lindsay, 12 Fed. Supp. 625 (D. C. Iowa, 1935);

In re Schoenleber, 13 Fed. Supp. 375 (D. C. Neb., 1936);

In re Davis, 13 Fed. Supp. 221 (D. C. N. Y., 1936);

In re Diggle (Commerce Clearing House Bankruptcy Service, New Matters, paragraph 3951) (D. C. Kan., 1936);

In re Tschoepe, 13 Fed. Supp. 371 (D. C. Tex., 1936);

In re Wogstad, 14 Fed. Supp. 72 (D. C. Wyo., 1936);

In re Mullikin (Commerce Clearing House Bankruptcy Service, New Matters, paragraph 4000) (D. C. Ind., 1936);

In re Maynard (Commerce Clearing House Bankruptcy Service, New Matters, paragraph 4184) (D. C. Idaho, 1936).

III.

Irrespective of the Constitutionality of the Frazier-Lemke Act, Under the Facts of the Case at Bar the Judgment of the District Court Should Be Affirmed.

A. The Frazier-Lemke Act Is Inapplicable to the Situation Presented by the Facts of the Case at Bar.

It is a principle of appellate jurisprudence that the court of appeal may affirm the judgment of the lower court although the grounds upon which the affirmance is based are different than those upon which the trial court made its ruling. This Court has recently restated and applied the proposition in *Montgomery v. Gilbert,* 77 Fed. (2d) 39 (C. C. A. 9th, 1935):

> "it is well settled that an affirmance need not be based on the same grounds as those which influenced the trial court."

This proposition is true even though the theory of the trial court was erroneous. *McCloskey v. Pacific Coast Co.,* 160 Fed. 794 (C. C. A. 9th, 1908).

There is also the rule that grounds presented to the trial court but not passed upon by it may properly be urged in the appellate court in support of the judgment. *Mosley v. Manhattan Oil Co.,* 52 Fed. (2d) 364 (C. C. A. 8th, 1931) (Certiorari denied, 284 U. S. 677, 76 L. Ed. 572, 1931.)

With these two principles before us we respectfully submit that even if the trial court had not desired to rule upon the constitutionality of the statute, or even if

the Court was of the opinion that the Act is constitutional, still under the facts and issues presented in this case the same judgment of dismissal would have been entered, and accordingly this Court should affirm the judgment.

It is to be recalled that one of the grounds urged by this appellee was that the appellant's city residence property, which was fifty miles away from the ranch property, was not incident to or necessary for the debtor's farming operations, that such city property did not properly fall within the terms and provisions of Section 75; and in other words that Section 75 was inapplicable. [Tr. p. 18.] It is also to be recalled that at the hearing before the District Court evidence was offered and received, and argument had, upon all of the issues raised, but that the Court thereafter elected to decide the cause solely upon the issue of constitutionality. [Tr. p. 20.]

In order to have before this Court all proper grounds of affirmance, we again present the argument that the Frazier-Lemke Act is not applicable to the property upon which this appellee had its encumbrance.

In the first place, the property in the city is fifty miles away from the ranch property. It is not reasonable to suppose that the framers of the Act intended it to operate in this "city house" and "country farm" situation, or to allow a debtor to lump together all of his property, urban as well as rural, and obtain relief with respect to all of it. Rather, it was the intent of the Act to assist, if constitutionally possible, the true farmer—one who lives upon and farms his land. If the other construction is placed upon the act it would logically lead to bizarre results. For example, suppose A owns a house in the city of Los Angeles which is encumbered by a trust deed. A lives

in this house the year around, and Los Angeles is his home. However, he owns farm property in Kansas and directs the farming by mail or has an efficient manager. If the holder of the trust deed on the Los Angeles house commenced sale proceedings under the trust deed, it would be a very forced construction of the Frazier-Lemke Act to allow A, by pleading he had a farm two thousand miles away, to prevent his creditor from enforcing the debt upon the security, namely, the Los Angeles house. Or again, suppose A has a farm and lives on it. In a large city several thousand miles away he owns a house which he inherited, but which is subject to a trust deed. To allow A to lump his farm and city property together under the Act when foreclosure threatened the city house, and thus save the city property, would cause an unjust result and would be a very forced construction of the Act. But in the present case the appellant is asking this Court to place just such a strained and illogical construction upon the Act when he insists that his city property, his residence, be lumped together with his alleged farming property many miles away.

Also, other provisions of the Act indicate that it is inapplicable to the present case. Paragraph 2 of Subsection (s) provides for the payment of rental which is not to commence for one year, and that the rental shall be based upon the rental value, net income and earning capacity of the property. These provisions cannot really be applied to city residence property occupied by the debtor and wholly unattached from the farm property. The city residence has no net income or earning capacity, and rent is customarily paid monthly, not annually.

B. Appellee Had No Bona Fide Hope of Eventual Rehabilitation, and Therefore His Petition for Relief Under the Frazier-Lemke Act Was Not Filed in Good Faith.

Another ground upon which this appellee based its argument in the trial court was that appellant in filing his petition for relief actually had no bona fide hope of ability to eventually rehabilitate himself, regardless of the length of the stay granted him, and that therefore the petition was not filed in good faith. [Tr. p. 19.]

At the date of the hearing below the appellant owed this appellee $27,000.00, although the property had been appraised in the proceedings as being reasonably worth only $21,000.00. The appellant had offered to pay appellee only this appraised figure. [Tr. pp. 16 and 17.] With these figures before it, it must be apparent to the Court that the appellant had no hope of eventual rehabilitation, and in fact had no desire to pay off the encumbrance eventually. At that time the debt was $6,000.00 more than the appraised value; at the end of a three-year stay under Subsection (s) the property would have *decreased* in value, whereas the debt would have *increased*. It would not be to the debtor's economic advantage to pay off the debt.

Further, there was offered no assurance that the rental would be paid, that taxes would be paid (and at that time one full year's taxes were delinquent and another year's payable, though not delinquent), and that the property would be kept in good condition and repair, for no security

for all of these necessary payments is required by the Act. We do not believe that it can be insisted that such a showing assured the Court that the appellant honestly desired an opportunity to pay his debts. If the petition for relief was not filed in good faith, and if no showing of probable ability to pay the debts eventually was made, then the petition must be dismissed, for otherwise this will be an imposition upon the Court, for the Court will be lending its powerful assistance to enable an unworthy debtor further to harass the creditor. We do not understand that the chancellor will lend his support to such an inequitable scheme.

Decisions holding that the petition under the Frazier-Lemke Act must be filed in good faith and with the probable hope of debt payment have been rendered.

In *In re Borgelt,* 79 Fed. (2d) 929 (C. C. A. 7th, 1935), the facts were surprisingly similar to the case at bar, for there also the property was valued at less than the encumbrance upon it and the farmer debtor offered to pay less than the amount of the debt. Upon such a showing the trial court dismissed an order restraining a foreclosure sale by the creditor, and upon appeal this dismissal was affirmed. The court said:

> "That subsection (s) presupposes a probability of eventual debt liquidation. It further presupposes a prior good faith effort on the part of the debtor to propose or accept a plan which is reasonably calculated to effect a debt liquidation. Here there was

no *bona fide* plan presented by the debtors, and the conciliator after a hearing reported that fact to the court. The evidence was overwhelming that there was not only no reasonable probability of an eventual debt liquidation, but there was no possibility of that result, and the debtors were not assured that they could procure a loan of sufficient amount to carry out their so-called plan."

A similar picture was presented to the Court in *In re Byrd,* 15 Fed. Supp. 453 (D. C. Md., 1936,) and there the Court dismissed the Frazier-Lemke Act proceedings, saying:

"But any reasonable interpretation of this subsection must presuppose a probability of the debtor's eventual liquidation of his debts. This in effect means that it is not sufficient for the petitioner merely to institute the proceedings with the wild hope that he will be able to have accepted, by the requisite number and amount of creditors, a plan for liquidation of his debts, but the hope must itself be founded upon reason, which means that there must be some probability of eventually liquidating his debts in conformity with the plan. In short, the act is not to be construed as affording protection to every petitioner who invokes its provisions without having substantially more to recommend him to the court for relief than his bare status as a farmer and his need of assistance."

And lastly, *In re Slaughter,* 13 Fed. Supp. 893 (D. C. Tex., 1936) enunciates the same rule, and the Court ordered the property sold for the creditor. This decision is especially significant, for it will be noted that the same Court and the same Judge in a prior hearing in the same case held, reluctantly, that the Frazier-Lemke Act was constitutional (*In re Slaughter,* 12 Fed. Supp. 206 (D. C. Tex., 1935)), and the appellant in the case at bar cites this decision in support of the constitutionality of the Act (App. Op. Br. p. 30). The later opinion recedes somewhat from the former position as to the validity of the Act, but irrespective of the constitutional question the Court in effect dismissed the proceedings upon the ground that there was no reasonable hope of eventual rehabilitation, saying:

> "It is repellant to the conscience of the chancellor that a debtor situated in so favorable a position should be permitted to hold off his creditor without any substantial evidence of hope of compliance with his obligation."

We respectfully submit that regardless of the question of constitutionality, under the facts of the case at bar and in accordance with the principle enunciated by the decisions herein discussed, this Court should affirm the District Court's judgment of dismissal.

CONCLUSION.

The judgment of dismissal heretofore entered by the District Court should be affirmed as to appellees John Hancock Mutual Life Insurance Company and California Trust Company for the reasons that:

1. The constitutionality of the Frazier-Lemke Act was a question properly to be considered by the District Court, since

(a) When the argument was made appellees had actually suffered injury which was the proximate result of the Frazier-Lemke Act, and additional injury was threatened to their existing property rights by the Act;

(b) The issue of constitutionality was submitted to the District Court by all parties;

(c) The argument that the lower court's action was premature was not presented to said court, and such action was not assigned as error. Accordingly, by the rules and decisions of this Court, such question is not properly before this Court.

2. The Frazier-Lemke Act is unconstitutional in that it violates the Constitution and amendments to the Constitution of the United States, since

(a) It is a Federal attempt to alter, control and impair property rights established by the laws of the several states and the attempted justification of such action under the bankruptcy powers of Congress;

(b) It deprives the appellees of property rights without due process;

(c) It is a Federal exercise of the police powers which are expressly reserved to the several states;

(d) It does not possess the uniformity requisite to a Federal statute.

3. Irrespective of the constitutionality of the Statute, the judgment should be affirmed as to these appellees because the facts of the case at bar disclose that

(a) The Frazier-Lemke Act does not and was not intended to apply to the situation existing between appellant and appellees;

(b) The petition for relief was not filed in good faith, since the petitioner did not have the requisite hope, desire or possibility of eventual payment of his obligation to appellee.

Respectfully submitted,

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